

# IRAN SANCTIONS AND REGIONAL SECURITY

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## HEARING BEFORE THE SUBCOMMITTEE ON THE MIDDLE EAST AND SOUTH ASIA OF THE COMMITTEE ON FOREIGN AFFAIRS HOUSE OF REPRESENTATIVES ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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TUESDAY, OCTOBER 23, 2007

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON THE MIDDLE EAST  
AND SOUTH ASIA,  
COMMITTEE ON FOREIGN AFFAIRS,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 3:10 p.m. in room 2172, Rayburn House Office Building, Washington, DC, Hon. Gary L. Ackerman, (chairman of the subcommittee) presiding.

Mr. ACKERMAN. Subcommittee will come to order.

As Yogi Berra said, it is hard to make predictions, especially about the future. But I will venture some today. I do not know when Iran will master the nuclear fuel cycle, but absent some kind of intervention, I predict they will do so.

I don't know when Iran will have enough special nuclear material to make a nuclear weapon, but I will predict that unless we stop them soon that day is sure to come. And I do not know when Iran will test its first nuclear weapon, but I will predict that on that day we will look back and ask why such a horrific seed was allowed to take root but worse, and most inexplicably, to come to full flower.

I know we will rue that day. I know that American people will look back and wonder how such a malevolent, disruptive, and yes, weak state was allowed to thumb its nose at the world and proliferate in plain sight. People around the world will ask how a state entirely dependent on foreign trade was allowed by the international community to acquire the means to put the whole world in danger.

And I will make one more prediction. That on that awful day of reckoning we will wish mightily that we could have another chance to stop Iran's mad mullahs from getting nuclear weapons. But there will be no second chance, only regrets, and for many, an enduring and sleepless fear. Because on that day many things will change in the Middle East and around the globe. On that day we may discover the Nuclear Nonproliferation Treaty—the NPT—long ill and weak, finally succumbed to international indifference.

And on that day we will discover that the prospects for Arab Israeli peace went from difficult to hopeless. And on that day we may discover that behind the shield of nuclear weapons Iran's hegemonic ambitions were far greater than predicted. We may discover that control of petroleum resources coming out of the Persian Gulf, the "casus belli" of the first Gulf War, lies in the hands of Tehran.

Moreover, Hezbollah and Hamas may be transformed from terrorist groups threatening dozens to potential delivery mechanisms for the murder of millions. As easy as it is to imagine this dark and unstable future where nuclear weapons rest in the hands of apocalyptic madmen, it is equally difficult to understand why the Bush administration has been so lackadaisical about averting this threat.

From the point at which it became clear that, thanks to Pakistan's A.Q. Khan, Iran had surreptitiously acquired the means to mass produce centrifuges and was at work on building a cascade of machines capable of producing quantities of enriched uranium sufficient for a nuclear weapons program. This problem should have been foremost in the mind of the President. To the great detriment of our national security, however, it was not, and to this day appears to remain a second order priority for the Bush administration.

News about Iran's enrichment facility at Natanz and its heavy water production facility at Arak reached the public in mid-August 2002. The revelation about A.Q. Khan came in August 2003. And in response the President, who took office in 2001, and swore the he would never ask for "a permission slip" to defend America, subcontracted this vital national security question to the EU3: Germany, Britain, and France. And surprising to no one, with America on the sidelines, the Europeans immediately went to work on making a deal with the mullahs. They offered one deal in 2003 and another in 2004; with the United States as an impassive observer, neither deal stuck.

In 2005, after the IAEA board of governors reported Iran to be in noncompliance with the NPT, the Bush administration chose another subcontractor, this time Russia, who again pursued a deal with the ayatollahs. This initiative also failed. In the middle of 2006, the Bush administration finally decided to exit the sidelines and boldly took up an ancillary role in European and Russian efforts to cut a deal with Iran. Despite, or perhaps because of the combination of European largesse and American indolence, Iran still seems to favor having nuclear weapons.

Since the middle of 2006, the United Nations Security Council has passed three resolutions demanding Iranian compliance with the NPT obligations and has in fact imposed some relatively mild sanctions on Iran. Yet even the watery sanctions by the Security Council have caused fractures within the Iranian regime to appear in public. The argument that sanctions do not affect the ruling class, only the poor and powerless, seems to have come undone in Iran where the threat of sanctions seems to be churning Iran's political waters quite vigorously.

Yet even now there is dispute in the Security Council about whether additional sanctions are justified. Even now President Putin is working to provide a safety valve to Tehran. Even now China remains more worried about limiting the power of the Security Council than stabilizing the source of the energy on which its economic future depends. Even now major states in the European Union, notably Italy, Spain, and Germany, are more concerned about economic dislocation than stopping Iranian nuclear bombs.

We need to be clear about what we are attempting. Our goal is not to teach Iran a lesson. Our true object is coercion. We are try-

ing to compel Iran to stop doing something that it wants to do or sees an advantage in continuing. The means to achieve this end is to realistically threaten costs that exceed the benefit Iran expects to gain from its acquiring an independent nuclear weapons capability.

For a state like Iran that has hegemonic and revolutionary ambitions, nuclear weapons offer a very substantial benefit as a shield, a license, and as an insurance policy. By comparison, we are barely scratching the surface in terms of the cost that continued defiance will impose on Iran. Even those Iranians willing to sacrifice their nuclear program must look at the pathetic efforts of the international community and believe either successful proliferation or a more generous offer or even both are headed in Iran's way.

For those genuinely committed to an Iranian nuclear weapon, the fecklessness of the United States and the international community must seem like a miracle, both inexplicable and welcome. The essence of coercive deal making is not complicated. Anyone who has seen *The Godfather* knows the words by heart: "I will make him an offer he can't refuse," and this simple step is exactly what we have not done.

We frittered away our strength and credibility in Iraq's civil war, we have subcontracted our security to others, we have checked our own sanctions at the door while others negotiate, and while we certainly indulge in plenty of bombastic rhetoric, we have never laid out for Iran our own carrots and sticks or even clear red lines. We haven't made Iran an offer it can't refuse because we haven't made either an offer or a threat, and I predict that until we do, and unless we do, our day of reckoning and regret will come even closer.

Now I would like to yield to my good friend and partner on the subcommittee, the distinguished ranking member, Mr. Pence.

[The prepared statement of Mr. Ackerman follows:]

PREPARED STATEMENT OF THE HONORABLE GARY L. ACKERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, AND CHAIRMAN, SUBCOMMITTEE ON THE MIDDLE EAST AND SOUTH ASIA

As Yogi Berra said, "It's hard to make predictions, especially about the future." But I'll venture some today. I don't know when Iran will master the nuclear fuel cycle, but absent some kind of intervention, I predict they'll do so. I don't know when Iran will have enough special nuclear material to make a nuclear weapon, but I will predict that unless we stop them soon, that day is sure to come. And I don't know when Iran will test its first nuclear weapon, but I will predict that on that on that day we'll look back and ask why such a horrific seed was not only allowed to take root, but worse, and most inexplicably, to come to full flower.

I know we will rue that day. I know the American people will look back and wonder how such a malevolent, disruptive and, yes, weak state was allowed to thumb its nose at the world and proliferate in plain sight. People around the world will ask how a state entirely dependent on foreign trade was allowed by the international community to acquire the means to put the whole world in danger.

And I'll make one more prediction: on that awful day of reckoning we will wish mightily that we could have another chance to stop Iran's mad mullahs from getting nuclear weapons. But there will be no second chance, only regret and for many, an enduring and sleepless fear.

Because on that day many things will change in the Middle East and around the globe. On that day, we may discover the nuclear Non-Proliferation Treaty (NPT), long-ill and weak, finally succumbed to international indifference. On that day we will discover that the prospects for Arab-Israeli peace went from difficult to hopeless. On that day we may discover that behind the shield of nuclear weapons, Iran's hegemonic ambitions were far greater than predicted. We may discover that control of the petroleum resources coming out of the Persian Gulf—the *casus belli* of the

First Gulf War—lies in the hands of Tehran. Moreover, Hezbollah and Hamas may be transformed, from terrorist groups threatening dozens, into potential delivery mechanisms for the murder of millions.

As easy as it is to imagine this dark and unstable future, where nuclear weapons rest in the hands of apocalyptic madmen, it is equally difficult to understand why the Bush Administration has been so lackadaisical about averting this threat. From the point at which it became clear that—thanks to Pakistan’s A.Q. Khan—Iran had surreptitiously acquired the means to mass produce centrifuges, and was at work on building a cascade of machines capable of producing quantities of enriched uranium sufficient for a nuclear weapons program, this problem should have been foremost on the mind of the President. To the great detriment of our national security, however, it was not, and to this day, appears to remain a second order priority for the Bush Administration.

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Since the middle of 2006, the United Nations Security Council has passed three resolutions demanding Iranian compliance with its NPT obligations, and has in fact imposed some relatively mild sanctions on Iran. Yet even the watery sanctions by the Security Council have caused fractures within the Iranian regime to appear in public. The argument that sanctions don’t effect the ruling class, only the poor and powerless, seems to have come undone in Iran, where the threat of sanctions seems to be churning Iran’s political waters quite vigorously.

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We need to be clear about what we’re attempting. Our goal is not to teach Iran a lesson. Our true object is coercion. We are trying to compel Iran to stop doing something it wants to do, or sees advantage in continuing. The only means to achieve this end is to realistically threaten costs that exceed the benefits Iran expects to gain from acquiring an independent nuclear weapons capability. For a state like Iran, that has hegemonic and revolutionary ambitions, nuclear weapons offer very substantial benefits as a shield, as a license, and as an insurance policy.

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Mr. PENCE. Thank you, Chairman. Thank you for calling this important hearing and bringing before us these extremely distinguished witnesses. I very much look forward to their testimony and appreciate your willingness to take on the hard issues consistently on the Middle East and South Asia subcommittee.

Mr. Chairman, as your strong statement made clear, there is widespread agreement on the threat that Iran poses. Iran's leader, Mahmoud Ahmadinejad, is a destabilizing force at the helm of a threatening country. His designs on leading a worldwide Islamic caliphate, his musings about wiping Israel off the map are as clear and as threatening as Mein Kampf was in the 1930s, or as clear as Osama bin Laden's writings were in the 1990s.

This is a man who is on a misguided mission, this is a dangerous and deluded leader, one who poses great threats to our national security, and we ignore his intents at our peril. Whether it is Holocaust denial or supporting terrorists from Lebanon to Gaza to Argentina a decade ago, Iran is no ordinary rogue regime. According to recent public reports by our field commanders, Iran has the blood on its hands of hundreds of United States troops in Iraq, because it is providing the components of explosively formed penetrators, a highly lethal roadside bomb.

As the United States Senate recently recognized, the Iranian Revolutionary Guard Corps should indeed be added to the foreign terrorist organizations list. A nuclear armed Iran would be all the more menacing. Preventing Iran from becoming a nuclear arms state must be one of the highest aims of American foreign policy. And I believe it is.

Vice President Cheney correctly stated just this last Sunday: "We will not allow Iran to have a nuclear weapon." President Bush's suggestion at last week's press conference that Iran with nuclear weapons could set off, in his words: "World War III" is not alarmist bluster.

This is not merely a provincial American concern. Europe, even France, has shown a refreshing level of concern about Iran. No fewer than four United Nations Security Council resolutions have called on Iran to cease and desist and make transparent its nuclear programs—the parallel to Iraq 5 years ago is striking.

Estimates vary as to how far along Iran's WMD efforts are, but there is very little dispute among those associated nations that Iran is in pursuit of weapons of mass destruction.

Mr. Chairman, I thank you for your strong statement, but I must point out that much of the criticism aimed at the administration alleges that it has not negotiated directly with the Iranians or at summits; said that it has not "engaged or pursued diplomacy vigorously enough." Conversely the administration is often criticized for not already preemptively ending the Iranian nuclear program. Yet our witnesses and the record make clear that the administration has offered numerous carrots to the Iranians in various instances over the last 2 to 3 years.

The Iranian regime has consistently rejected them in favor of pursuing weapons of mass destruction.

Mr. Chairman, your assessment is absolutely correct that coercive diplomacy is what our national goal must be and what I believe it is. I concur with you and our witnesses that we must pur-

sue avenues that make the cost for Iran to pursue nuclear weapons prohibitive. To this end, Treasury Undersecretary for Terrorism and Financial Intelligence, Stuart Levey, has done yeoman's work traveling the world and persuading allies and international business that investment in Iran is bad business, as well as wrong policy.

This is no easy task. Our relations with this country have vexed five straight Presidents extending back 28 years. This would be a formidable challenge under the best of circumstances. Our hearing today will shed light on how to best approach our shared goals and those matters upon which there is consensus even on this diverse committee and I look forward to the testimony as presented.

Mr. ACKERMAN. Thank you very much. Mr. Berman. Mr. Scott.

Mr. SCOTT. No comments.

Mr. ACKERMAN. Mr. Sherman.

Mr. SHERMAN. On 9/12/2001, Iran was a long way from a nuclear weapon; it had no sway in southern Iraq in spite of a similar Shiite faith, it faced Saddam Hussein who had killed hundreds of thousands of their soldiers, and oil was selling at \$25 a barrel. Now I'm not going to say that President Bush is the mahdi, but I am going to say that Iran has made spectacular progress under his administration.

A nuclear weapon in Iran's hands means they can block the Strait of Hormuz any time they wish with impunity. They can carry out any terrorist attack without fear of retribution. And if some day that regime thinks it is on the way out, it could very well decide to go out with a bang.

Missile defense in Poland and the Czech Republic does not protect us or our allies since a nuclear weapon is about the size of a person and is even easier to smuggle into a European country or into the United States.

We have had an administration that yells and screams that Iran with a nuclear weapon is unacceptable, but they believe something far more strongly and that is that no multi-national corporation should ever be inconvenienced in an effort to prevent the spread of nuclear weapons. And that is why they have kept our markets open to Iranian exports; not oil, but only the stuff we do not need and they could not sell elsewhere. That is why members of this administration have violated the law in order to protect Tehran and its business partners from the Iran Sanctions Act.

That is why we closed two Iranian banks off from doing U-turn transactions with the Federal Reserve Board branch in New York, while allowing all the other Iranian banks to do so. That is why we have not offered Russia any kind of a deal on issues Russia cares about in order to secure Russian support with regard to Iran.

We have had an incredibly feckless policy and we cannot say that the only alternatives are a bombing raid on the one hand or a Kumbaya approach to diplomacy on the other, and therefore, since Bush is avoiding those two things, he is carrying out a great policy. The fact is American corporations are free to do business with Iran through their foreign based subsidiaries and again and again Iran can laugh at those who want to impose sanctions.

The best example of this is their ability to show that World Bank loans, money we fight for when we fight for appropriations for for-

eign aid, go to Iran. What better symbol that the world is not serious; as a matter of fact the world is sending gifts.

And I wish to report to this subcommittee we had the Secretary of the Treasury before Financial Services, and he stated two very important things. First, that he had worked hard to try to keep Wolfowitz's job; he had made phone calls, he had implored the other Finance Ministry officials, but that he had not made a single phone call to prevent the disbursement of World Bank loans to Iran. And second, that the administration's position with regard to the statute that the Iran Sanctions Act is: They do not think it is good public policy so it has no force of law, or at least will not be adhered to.

So I look forward to a day when Iran is democratic; I look forward to a day when the United States is a democracy that follows its own Constitution and administration actually follows statute. And I yield back.

Mr. ACKERMAN. Thank you very much. The members of the panel—being very anxious to hear from our two very distinguished witnesses—have asked that we proceed directly to them at this point, which we will do.

The subcommittee is pleased to welcome Dr. Philip Gordon and Mr. Ilan Berman.

Philip Gordon is Senior Fellow for U.S. Foreign Policy at the Brookings Institution in Washington, where he has worked since 2000. Prior to coming to Brookings, he was Director for European Affairs at the National Security Council under President Bill Clinton. He has held other teaching and research posts—at the International Institute for Strategic Studies in London and the Johns Hopkins University School of Advanced International Studies in Washington, among others.

Ilan Berman is Vice President for Policy at the American Foreign Policy Council in Washington and has worked as a consultant both for the U.S. Central Intelligence Agency and the Department of Defense. Mr. Berman is adjunct professor for international law and global security at the National Defense University and is the editor of the *Journal of International Security Affairs*.

I would ask each of you to summarize your remarks if you can for approximately 5 or so minutes and your written statements will be made a part of the permanent record as you have presented them.

Dr. Gordon, you may proceed.

**STATEMENT OF PHILIP H. GORDON, PH.D., SENIOR FELLOW  
FOR U.S. FOREIGN POLICY, FOREIGN POLICY STUDIES PROGRAM,  
THE BROOKINGS INSTITUTION**

Mr. GORDON. Thank you, Mr. Chairman, and thank you for the opportunity to testify on what I think is a really important issue. As I said at the start of my written testimony, I think it is the question of how we get other countries to help the United States impose costs on Iran that is particularly important for the following simple reason.

To be perfectly honest, it is not certain that even if we do win international support for such efforts to isolate Iran, we will manage to prevent them from developing nuclear weapons. What is cer-

tain is that if we fail to do so, our strategy will fail. The United States itself has not significantly traded with or invested in Iran for nearly 30 years. There is not a lot more we can do. What is critically important is getting the rest of the world onboard for a strategy of using these economic and diplomatic levers to persuade Iran, as was already stated, that the costs of developing nuclear weapons are greater than the benefits.

So with that premise I would like to make a couple of points about the state of play with our key partners, the Europeans, the Chinese, and the Russians, and then offer a couple of suggestions about how we go about this very difficult issue of persuading them to join us in this strategy.

Three points about where we are with our European, Russian, and Chinese counterparts. First, I think the EU3 process whereby France, Britain, and Germany have taken the lead has largely been a good thing. It has kept the Europeans together, prevented Iran from playing them off against each other, as it had been doing before, and even more importantly by having the EU in the lead, it gives the Europeans a major stake in this issue.

The European negotiators are being stood up by the Iranians and because the EU has put its credibility on the line, it is more serious about this issue. It cannot hide behind the United States in the way that it could have 2 years before.

Second point, I believe that winning European support for isolating Iran is very difficult but not impossible. As we all know, Europeans are highly reluctant to pursue sanctions, often for economic reasons. Germany had more than \$5 billion worth of exports to Iran last year, there are a lot of enticing investment opportunities that they sometimes find hard to resist, some European countries more than others, and they are also averse to the sorts of coercive approaches that we have been talking about, fearing that they lead to tensions.

All of that said, I think that the combination of rising American pressure, EU3 leadership, the desire to avoid a military conflict, and, frankly, Iranian behavior and the behavior of the Iranian President, has led to an increase in the political and economic isolation of Iran and European's willingness to impose it.

In the past year we have seen European banks, including Deutsche Bank, HSBC, BNP Paribas, and many others largely stopping doing business with Iran. New export credits from Germany and other countries are on the decline. German exports to Iran in the first part of this year fell by nearly 20 percent. Major energy companies including France's Total, Spain's Repsol, and the Anglo-Dutch group Royal Dutch Shell have delayed their investments repeatedly.

And I think these new constraints that we are seeing from our European friends are starting to have an effect on the already troubled Iranian economy and particularly its ability to make badly needed investment in its energy sector. And the EU has said that if the Russians and the Chinese don't go along at the Security Council this round, they would be prepared to take action outside of the Security Council.

On that point, I think it is particularly important to mention the role of the new French President, Sarkozy, who has changed the

French position in taking the lead in trying to persuade his European partners to tighten the sanctions and to be willing to do it outside of the Security Council. Sarkozy seems to be persuaded by the notion, as he has put it, that we need to act diplomatically and economically to prevent that ultimate choice between an Iranian bomb and the bombing of Iran.

Third, therefore, I think the real problem is China and Russia. There is more that the Europeans can do, and I will say something about that in a moment. But what we are finding is that the real challenge at the Security Council is not the European Union members but China and Russia. The Chinese position seems to me relatively straightforward. They do \$14 billion worth of trade with Iran. They are not keen to give that up. But if the Russian position were different, I don't think China would want to be the one blocking the next round of measures. Russia is really the obstacle at present.

Frankly, President Putin seems more intent on denying the United States an opportunity for a diplomatic success than he seems to be on increasing pressure on Iran. Russia also argues that it would pay the price for further sanctions with Iran because it is the one with nuclear arrangements with Iran, arms sales with Iran, and the Russians show no sign of budging on that issue.

I would even go so far as to suggest or to wonder whether the Russians wouldn't say have an interest in a military conflict between the West and Iran, but they don't seem particularly averse to that. That would increase America's diplomatic isolation in the world even more. It would drive up oil prices, and one can even speculate that maybe that would be welcomed in Moscow. President Putin claims that he opposes Iranian nuclear weapons, but he hasn't really shown any willingness to act on that issue.

With that problematic situation, trying to get the Europeans, Chinese and Russians on board for this strategy of making Iran pay a price, what can we do? And I will briefly enumerate five things that I think we can do to win more support on this issue.

And I would also add as a preface to that, it is often said that sanctions, that this sort of economic and diplomatic pressure can't work, but I think that overlooks evidence in places like South Africa, Serbia, Libya, and even the former Soviet Union. When they are broad-based, multilateral and sustained, sanctions can have important positive effects, especially in diverse societies with educated populations and civil society groups and at least partially democratic institutions, and much of that applies to Iran.

So what can we do? First we have to continue the process in the Security Council and not give up on it. Russia and China as I mentioned for now oppose a further resolution and sanctions on Iran, but they also share the West's interests in preventing Iran from developing a nuclear weapon. If Iran continues to move in the direction that it is and in particular if it refuses to answer the IAEA's questions about its past nuclear program, it may be possible to get Moscow and Beijing on board for a further resolution just as in July and December 2006 and in March 2007.

We need absolutely to engage directly with the Chinese and the Russians to find out what it is they need in order to get on board for this and no doubt to give them a role in the negotiations and

an economic stake in the outcome. Without that, I fear they won't be on board.

Second, I think we need to continue our pressure on the Europeans, political and economic, to increase their economic isolation of Iran. As I noted, the Europeans have already taken significant steps in that direction, but as I also noted, there is more that they can do, and particularly that is true on export credits and cutting off investments in Iran. If the Security Council refuses to act, the EU should be pushed to do so on its own outside the Security Council.

I do want to be clear about one thing. My own view is that United States legislative efforts to force the Europeans to do so can backfire in that legislation that takes away the President's ability to waive those sanctions on Iran, while one understands the motivation behind it, risks turning this issue into a debate between us and the Europeans and procedures at the World Trade Organization and elsewhere rather than a focus on isolating Iran, which is where I think the effort needs to be. And as I say, fortunately we are making progress in that regard.

A third point. I think we need to do more to put public pressure on the companies that are making significant investments in Iran. Together with our EU allies, the United States should publish the names of companies that are making those major investments and encourage others, including public sector firms and public and private pension funds, not to do business with them. And the U.S. Government should provide legal protection to private fund managers and state and local governments who divest assets from companies that are propping up the Iranian economy.

Fourth, the United States should complement its efforts to increase the price Iran pays for lack of compliance with incentives for Iran to cooperate. This seems to me a necessary counterpart to the sticks. So long as the Iranians believe the United States is implacably opposed to their country no matter what they do, they are unlikely to compromise on the nuclear issue. If, on the other hand, Iranians can be convinced not only that there are high costs of pursuing nuclear weapons but also concrete benefits for not doing so, then I think there is a chance an agreement can be reached.

And I think, by the way, that our efforts to do so are also critical in getting our European friends and others to come along with us. When we show we are willing to engage directly with the Iranians and offer them something for their cooperation, then the Europeans are more willing to get on board for the disincentive side of the equation.

Fifth and finally, I think we should be clear and make absolutely clear to the Europeans, the Russians and the Chinese that if we do not impose costs on Iran for developing a nuclear weapons capability, we are effectively announcing the end of the nuclear non-proliferation regime. If the international community isn't prepared to make a country with Iran's track record pay a price for developing nuclear weapons, then any threats to punish any other less potentially dangerous proliferators would frankly be hollow.

And to that, I would add and I will conclude with this, even if tighter economic sanctions do not persuade Iran to halt its nuclear program right now as is our interest and desire, there will come

a time 6 months from now, a year from now, 2 years from now or later, maybe with a different Iranian leadership, where serious negotiations might well begin. And at that point, we are going to need leverage to use in those negotiations.

So, to conclude, as I said at the very beginning, there is no guarantee that we would have success even if we managed to persuade these other key allies to get on board for the strategy that we are pursuing. But the only way to find out is to increase the costs to Iran for lack of compliance while holding out the possibility of a better future for the Iranian people if Iran is willing to compromise. What I propose is a frustrating and uncertain policy course, but I think it is better than the alternatives of acquiescence or war. Thank you very much.

[The prepared statement of Mr. Gordon follows:]

PREPARED STATEMENT OF PHILIP H. GORDON, PH.D., SENIOR FELLOW FOR U.S. FOREIGN POLICY, FOREIGN POLICY STUDIES PROGRAM, THE BROOKINGS INSTITUTION

Mr. Chairman, Members of the Committee,

Thank you for the opportunity to testify today. The question of how to achieve greater international support for U.S. efforts to isolate Iran politically and economically—with the goal of preventing it from acquiring nuclear weapons—is critically important. To be perfectly frank, it is uncertain whether even if the United States does receive the full cooperation of its European and UN Security Council partners it will be able to stop the Iranian nuclear program—Iran seems determined to move forward with plans to develop a full nuclear fuel-cycle that would leave it a short step away from a weapons capability. What is certain, however, is that without broader international support American efforts to isolate Iran will fail. The United States has not significantly traded with or invested in Iran for nearly 30 years; it is only by persuading other major countries not to do so that it stands any chance of convincing Iran that the economic and diplomatic costs of developing nuclear weapons are greater than the perceived benefits.

The good news is that none of America's most important partners wants to see Iran develop nuclear weapons, and most have already taken at least some steps to sanction the Iranian regime. Since July 2006 the UN Security Council has passed three resolutions demanding that Iran suspend all enrichment-related activities, the last two of which imposed limited economic sanctions against Iran, including constraints on Iran's arms exports, restrictions on nuclear trade with Iran, and a ban on financial dealings with individuals connected to Iran's nuclear and missile programs. The European Union has taken the lead in diplomatic efforts to stop the Iranian enrichment program, most European governments are cutting back on loan guarantees to Iran and encouraging their major companies not to invest there, and the EU is now considering economic sanctions outside of the Security Council if Russia or China refuse to move forward.

At the same time, the limits of international support for political and economic pressure are also apparent. Russia and China often seem more intent on blocking U.S. leadership than on containing Iran and continue to oppose more than limited economic sanctions at the Security Council, while many European countries remain reluctant to sacrifice economic interests in Iran to strengthen sanctions that they doubt in any case will work. In this complex and challenging context, I'd like to focus my testimony on two main areas: an assessment of European attitudes and the dynamics within the EU, and to a lesser extent in Russia and China; and proposals for how the United States can most effectively encourage its allies to support effective economic and diplomatic pressure on Tehran.

#### *European Attitudes and Policies*

Europe's motivation for taking a leading role in the Iranian nuclear issue stemmed in part from fears in the fall of 2003 that without a new diplomatic effort the United States might use military force against Iran. Iranian dissident groups had just revealed the full extent of Iran's secret nuclear enrichment program, and after the U.S. invasion of Iraq the Europeans feared that Washington might consider regime change in Iran if Europe could not demonstrate the effectiveness of a diplomatic alternative. The result was a new diplomatic structure—the EU3 (Britain, France and Germany) taking the diplomatic lead on behalf of the rest of the

EU, and a deal in which Iran agreed to suspend enrichment of uranium while negotiating with the Europeans.

The EU3 approach to the Iran issue has had several benefits. It has kept the Europeans relatively united and made it more difficult for Iran to play different member states off each other. Even more importantly, however, EU leadership has given the Europeans a major stake in the Iran nuclear issue. By stepping forward to demonstrate that Europe can take the lead and that diplomacy can work, the EU has put its credibility on the line and Europeans are less likely to hide behind or blame the United States. This dynamic has certainly affected the European negotiators themselves—by experiencing directly Tehran's obstreperousness and lack of transparency on the nuclear issue, the Europeans who have been dealing with Iran have been driven to advocate an increasingly hard line on the issue.

Even while noting the relative EU unity on Iran, it is important to recognize the differences of the key European actors, even among the EU3. Britain, with its own historic difficulties with Iran (most recently the capture of 15 British sailors that Iran accused of trespassing in Iranian waters) and relatively limited economic interests there, has from the start taken the hardest line on the Iranian nuclear program. Like other European countries, it prefers that sanctions be implemented through the UN Security Council but it is prepared to support national and EU sanctions outside of the Council if UN agreement cannot be reached. The British acknowledge that steps taken so far have not persuaded President Ahmadinejad to back down but believe that in the long run a different Iranian leadership might be willing to compromise on the nuclear issue.

France also takes a relatively hard line, and increasingly so. Whereas former President Jacques Chirac had privately suggested an Iranian nuclear weapon would not pose a major threat and was strongly opposed to any EU sanctions not approved by the Security Council, President Nicolas Sarkozy has taken a much tougher line. Calling an Iranian bomb "unacceptable," Sarkozy has taken the lead on the issue within Europe and is now seeking to persuade his European partners to impose EU sanctions if the Security Council refuses to do so. Sarkozy has also broken with the Chirac approach by publicly appealing to major French energy companies like Total not to invest in Iran. In a speech in Paris in August, Sarkozy called on Europe to act to prevent an ultimate choice between "an Iranian bomb and the bombing of Iran." Foreign Minister Bernard Kouchner has also suggested that the failure to prevent an Iranian nuclear weapon diplomatically could result in "war." Both French leaders have made clear that they are not advocating military force but instead warning their EU partners—as well as Russia and China—that the consequences of diplomatic failure could be catastrophic.

Germany is more reluctant to support economic sanctions—whether at the Security Council or outside it. This reluctance derives in large part from Germany's considerable economic interests in Iran, which include some \$5.7 billion in exports to Iran in 2006 (compared to less than \$1 billion for Britain and \$2.6 billion for France) and exposure of over \$5 billion dollars of export credit guarantees. But it also stems from a general uneasiness with coercive measures. German diplomats argue that tightening sanctions on Iran will lead to greater tensions, increase the risk of conflict, and make Iran even more determined to develop nuclear weapons for its defense. They argue that sanctions outside of the UN would be ineffective, would undermine multilateral diplomacy, and would harm relations with Russia and China. There are also splits within Germany's coalition government on the issue: Chancellor Angela Merkel of the conservative Christian Democratic Union takes a relatively hard line on the issue (About Ahmadinejad, she has said that "a president that questions Israel's right to exist, a president that denies the Holocaust, cannot expect to receive any tolerance from Germany") while her Social Democratic Party coalition partners, including Foreign Minister Frank-Walter Steinmeier, are more skeptical of a coercive approach.

Some other European countries—Italy and Austria, for example—are even more reluctant to strengthen sanctions on Iran. Italy is one of Iran's largest trading partners, with bilateral trade last year totaling over \$7 billion and over \$4 billion in export credits at risk. It is also a major investor in Iran, notably through the energy company, Eni. Italy also resents its exclusion from the EU3 and lack of a seat at the negotiating table.

Winning greater European support for isolating Iran is therefore difficult—but not impossible. For all the European reluctance to pursue sanctions, the combination of rising American pressure, EU3 leadership, and Iranian behavior—both its refusal to cooperate on the nuclear issue and the provocations of its president—has led to an increase in the economic and political isolation of Iran. European banks—including Deutsche Bank, HSBC, and BNP Paribas—have largely stopped doing business with Iran. New German export credit guarantees to Iran have fallen from \$3.3 bil-



lion in 2004 to \$1.2 billion in 2006, and German exports to Iran fell by 18 percent in the first half of 2007. Major investments in the Iranian energy sector—such as those planned by France’s Total, Spain’s Repsol, and the Anglo-Dutch group Royal Dutch Shell—have been delayed repeatedly. These new constraints are having an effect on Iran’s already troubled economy and particularly on its ability to make badly needed investment in its energy sector. EU leaders have said that if the Security Council is unwilling to follow up on its threats to impose further sanctions for Iran’s lack of compliance they will agree to do so at the EU level.

The greater challenge is with China and Russia. Although both surprised Iran with their willingness to agree to Chapter VII UN Security Council resolutions making Iranian uranium enrichment illegal and imposing limited economic sanctions, they have since resisted further economic pressure, despite Iran’s continued lack of compliance. Russia, in particular, seems more intent on denying the United States a diplomatic victory than on increasing economic pressure on Iran. Russia also argues that since the United States already does not invest in or trade with Iran, Moscow would bear the brunt of any new sanctions that would interfere with its nuclear trade with Iran and arms sales. President Putin claims that he opposes Iranian nuclear weapons but has seen no evidence that they are pursuing them, and his recent visit to Tehran seemed to be a signal that little can be expected from Russia on this issue. China would probably not stand in the way of action against Iran if Russia changed its stance, but Beijing has shown little interest in sacrificing its considerable economic interests in Iran (China’s \$14 billion annual trade with Iran is more than any other country in the world) for the sake of nonproliferation.

#### *Moving Forward*

The United States must continue to work to persuade its partners to increase economic and diplomatic pressure on Iran. There is of course no guarantee that escalating political and economic sanctions will succeed in changing Iranian behavior or contribute to a change in the Iranian regime, but given the alternatives—acquiescing to Iranian nuclear capabilities or a military strike that could prove costly and counterproductive—it makes sense to find out. Many argue that sanctions never work, but this argument overlooks experiences in places like South Africa, Serbia, Libya, and even the former Soviet Union, where economic problems exacerbated by limits on Western investment helped produce the Gorbachev era and the end of the regime. When international economic and diplomatic sanctions have been broad-based, multilateral and sustained, they have sometimes had important, positive effects, at least in diverse societies with educated populations, active civil society groups, and at least partially democratic institutions—like Iran. The current Iranian regime seems determined to continue developing a potential nuclear-weapons capability, but economic development is a higher priority for the Iranian public and a far greater imperative for the country as a whole. (In polls conducted in summer 2007 by the bipartisan group Terror Free Tomorrow, 80 percent of Iranians said they favored Iran offering full international nuclear inspections and a guarantee not to develop or possess nuclear weapons in return for outside aid.)

To most effectively increase international pressure on Iran, the United States should pursue a number of separate tracks simultaneously. First, it should continue the process of trying to reach consensus at the UN Security Council for a new resolution imposing further sanctions on Iran. Russia and China continue for now to oppose such a resolution but they also share the West’s interest in preventing Iran from acquiring nuclear weapons. If Iran continues to move in that direction—and if it fails to answer the International Atomic Energy Agency’s unresolved questions about its past nuclear work—Moscow and Beijing might choose to send another message to Tehran, as they did in July and December of 2006 and in March 2007. While necessarily pursuing its own interests and standing for important international principles, the United States should also take care to avoid unnecessary clashes with Russia and China, which only make them even less willing to work with issues of importance to Washington.

Second, the United States should continue to apply political and diplomatic pressure on its European allies to increase their economic isolation of Iran. As noted, the Europeans have already taken significant steps in this direction, but there is much more they could do. This includes ending the practice of extending government backed loans to Iran (still some \$18 billion for the EU as a whole as of 2005), convincing European banks to stop doing business in Iran, and cutting off major European investments in the Iranian energy sector. If the Security Council proves unwilling to apply the further sanctions currently under consideration, the EU should be encouraged to do so on its own. “Unilateral” EU sanctions would not mean abandoning the UN process, only that the Europeans would move forward while continuing to press the Security Council to do so at a later date. While American en-

couragement and diplomatic pressure have in recent years succeeded in getting Europeans to cut back their economic relationships with Iran, I believe that U.S. legislative efforts to force them to do so could backfire. Legislation that took away the President's ability to waive U.S. sanctions on European countries investing in Iran could result in legal challenges at the World Trade Organization, an EU determination to fight the principle of secondary sanctions, and EU retaliation against American companies. A better approach is to continue to support British and French leadership in getting the EU to uphold its moral responsibilities as a key international actor.

Third, the United States should do more to put public pressure on the companies that are making significant investments in Iran. It should, together with EU allies, publish the names of the companies that are making major investments and encourage others—including public sector firms and public and private pension funds—not to do business with them. It should provide legal protection to private fund managers and state and local governments who divest assets from companies that are propping up the Iranian economy.

Fourth, the United States should remind its allies that the failure to take action to isolate Iran increases the risk of military conflict. This need not—and should not—take the form of a threat to use force against Iran but is simply a recognition of the reality that, as President Sarkozy has noted, the failure to deal with this issue diplomatically could reduce the international community's options to military force or an Iranian nuclear weapon. The allies should be made to understand that the less they do to contain Iran politically and economically, the more likely it is that the Bush administration—or Israel—will use force against Iran.

Fifth and finally, the United States should complement its efforts to increase the price Iran pays for lack of compliance with the will of the international community with incentives for Iran to cooperate. So long as Iranians believe the United States is implacably opposed to their country no matter what they do they are unlikely to compromise on the nuclear issue. But if Iranians can be convinced not only that there are high costs of pursuing nuclear weapons but also concrete benefits for not doing so, there is a chance that an agreement can be reached. U.S. openness to dialogue with Iran is also important for convincing Europeans and others that the failure to resolve the issue is not simply due to American stubbornness. Indeed, the Bush's administration's gradual willingness after 2005 to engage with Iran—backing the EU3 process, offering potential incentives like spare aircraft parts and WTO membership, supporting various ways to provide fuel to Iran for a civil nuclear program, and talking directly to Iran about Iraq—has helped make it easier for the Europeans to match these “carrots” with “sticks” of its own. The United States should consider further steps in this direction, including direct talks with Iran about the nuclear program.

As I noted at the beginning of this testimony, there is no guarantee that even U.S. success in persuading its partners to further isolate Iran will persuade the current regime to freeze its nuclear enrichment program. That goal seems highly unlikely to be achieved in the short term, and may even prove elusive in the long term. The only way to find out, however, is to increase the costs to Iran for lack of compliance while holding out the possibility of a better future for the Iranian people if Iran is willing to compromise. Even if tighter economic sanctions do not persuade Iran to halt its nuclear program now, there may well come a time in one year, two years, or later—perhaps with a different Iranian leadership in place—when serious negotiations will begin, and the United States and Europe will need leverage to use in those negotiations. We should also be clear—and make absolutely clear to the Europeans, Russia, and China—that if we do not impose costs on Iran for developing a nuclear weapons capability, we are effectively announcing that the nuclear non-proliferation regime is dead. For if the international community is not prepared to make a country with Iran's track record pay a price for developing nuclear weapons, any threats to punish other, less dangerous proliferators would be manifestly hollow.

This is a frustrating and uncertain policy course: but it is far better than the alternatives of acquiescence or war.

Mr. ACKERMAN. Mr. Berman.

**STATEMENT OF MR. ILAN BERMAN, VICE PRESIDENT FOR  
POLICY, AMERICAN FOREIGN POLICY COUNCIL**

Mr. BERMAN. Thank you very much. And I want to take an opportunity to thank Chairman Ackerman and Ranking Member

Pence for holding this hearing and for inviting me here to testify. It is a pleasure and a privilege.

You have my written testimony. It has been entered into the record. I would like to just focus on three things that I talked about at length in my written remarks. These are: The intrinsic vulnerabilities in the Iranian economy, what we are currently doing to exploit them, and what more we should do.

So it is a good place to start to talk about the fact that there are four fundamental vulnerabilities in the Iranian economy. The first derives from the fact that Iran is deeply dependent on foreign sources for refined petroleum. Iran is a major oil exporter. It produces almost 4 million barrels of oil a day, but it lacks adequate refining capacity. We know that it currently imports approximately 40 percent of its total annual gasoline consumption from abroad. We know how much this costs.

During the last Iranian calendar year, March 2006 to March 2007, it spent about \$4.2 billion in gasoline purchases from abroad. This is significant because this is roughly 10 percent of the total excess revenue that Iran has gained from the high price of world oil since 9/12, and we haven't even economically begun to fight. So I think that is a significant point to make.

We also know where this gasoline comes from. It comes from 16 countries, or at least it did last year, including the United Arab Emirates, India, the Netherlands and France. And we also know that these deliveries are not surplus. The Iranian regime, according to authoritative studies, lacks anything resembling a strategic petroleum reserve. It has approximately 45 days' worth of gasoline inside the country, and without that gasoline, it will have major distortions in its economy, and partial cutoffs of supply could even result in events that are threatening to regimes' stability, including a rise in prices or additional limits on consumption they are forced to impose.

The second vulnerability is Iran's economic hierarchy. Today the vast majority of wealth in the Islamic Republic is localized in the hands of a very small number of people and organizations. Among them are the extended family of the former Iranian President, Hashemi Rafsanjani, which now virtually controls copper mining, the lucrative pistachio trade, and other industries. We also should look at the Iranian bonyads, which are the largely unregulated social religious foundations which account for something like 30 percent or more of Iran's national GDP.

And the third "super-empowered" actor in the Iranian economy is the Pasdaran, the Iranian clerical army, the Revolutionary Guard Corps, which is in command of numerous construction, industrial, transportation and energy projects valued in the dozens of billions of dollars. Given this hierarchy, if we apply targeted financial measures that restrict the ability of these individuals or these organizations to access international markets or to engage in international commerce, you are likely to see a pretty dramatic shift in regime decision-making. You will capture their attention, in other words.

The third vulnerability is foreign direct investment into Iran. We all know that Iran has benefited tremendously from the high price of world oil over the last 6½ years. The Iranian economy in the

late 1990s was almost at the point of implosion with gasoline prices in the mid teens a barrel. As of March 2006, officials in Tehran were publicly estimating their country's hard currency reserves at some \$50 billion, so they have come a long way.

But we also know that Iran needs substantial foreign direct investment to maintain its status as a major energy exporter. Iran's energy sector requires some \$1 billion annually to maintain current production and \$1.5 billion to increase it. And without such sustained capital, it will begin to eat itself. Iran will revert from an energy powerhouse to a net energy importer over the span of very few years. At least that is what the projections say.

The fourth vulnerability is Iran's trade relationships. We know that Iran has spent a large amount of time and a large amount of political capital over the last several years expanding its trade ties to Europe, to Asia and also to new clients, such as the countries of the post Soviet space, the Caucasus and Central Asia. We know that it is making significant headway there as well.

But these ties are as much a liability as they are an asset because the vast majority of Iran's trading partners trade with us and trade much more with us than they do with Iran. A good example here is Japan. The annual two-way trade between Japan and Iran totaled \$3.7 billion in 2004, 2005. The same period of time, Japan's bilateral trade turnover with us was almost 50 times that.

So there is a considerable amount of leverage that we can exert over these countries. If they are forced to choose, Iran's trading partners will inevitably prioritize commercial relationships with the United States over commercial relationships with Iran. We simply haven't asked them to choose or force them to do so.

This gets me to my second point: What are we doing about it? The answer is not much. So far the U.S. Federal Government has only partially exploited these vulnerabilities and points of entry into the Iranian economy. Working through the U.N., we have imposed selective asset freezes and travel bans, but in contrast to my colleague, I actually don't hold out great hopes for the United Nations track for the simple reason that the timing is not working in our favor. It takes a long time to pass additional resolutions, and a lot of haggling. And also because two of the decision-makers, Russia and China, have provided and in some cases continue to provide key inputs into the Iranian nuclear program, and asking them to impose sanctions that bite would simply work against their long-term strategic interests.

We have also launched a unilateral effort to force companies and financial institutions to end or scale back their ties with the Islamic Republic, and this is having some effect. These are the financial services sanctions that Congressman Pence talked about. Currently two of Iran's six state-owned banks have been blacklisted from the United States financial system, and more such designations are likely to come down the pike.

Also, Congress has already voted, the administration is still deliberating but is deliberating in Congress's favor, to designate the Iranian military clerical army, the Iranian Pasdaran, as a specially designated global terrorist entity, and this will allow far greater financial action against Pasdaran assets and Pasdaran-linked com-

panies. But that is it. That is all we are doing so far on the Federal level. There is much more that can be done.

Let me end here by mentioning three concrete things, that the United States Government can—if I will be excused for using the word—weaponize against the Iranian regime. The first is to impose a gasoline embargo. There has been legislation that has been floating around Congress for a number of years now, and I believe it deserves a serious second look.

The Achilles heel of the Iranian regime is the intersection between poor socialized economic planning and its dependence on foreign refined petroleum. Even today, even though Iran has imposed a number of cost-limiting measures such as a gasoline rationing plan, if we imposed even a partial cutoff of gasoline to the Iranian regime, Iran would either have to ratchet up prices for the domestic supplies that it has or begin to limit further the access ordinary Iranians have to that gasoline. Both of these could dramatically affect the regime's stability.

The United States should work with its allies—here I agree with my colleague, multilateralism is the key—to pressure the 16 countries that I mentioned and to test that proposition; to test whether it is possible to bring Iran to the table by way of a gasoline embargo.

The second element that we can weaponize is unilateral sanctions. All of you know better than I that Congressional measures such as the Iran-Libya Sanctions Act, now the Iran Sanctions Act, have been honored completely in the breach. Congress wanted when it passed ILSA in 1996 to send a clear message to foreign firms that they can trade with us or they can trade with the Iranians, but not with both. This has not been honored.

And these measures, by not being honored, have essentially provided Iran with the idea that it can tell companies that trading with them is essentially a cost-free venture. We need to really implement those measures and begin to enact them in a robust way, because inaction on that front is simply not an option any longer.

It is also clear that such measures, if they are implemented properly, can have a pretty substantial impact on foreign decision-making. The example I will give is the one that emerged just today from the wires, that Russia's second largest oil concern, Lukoil, has decided unilaterally to cease work in the Iranian energy sector. The reason that Lukoil's CEO cited for this decision was because, I'm paraphrasing of course, sanctions are coming, and we are in violation of ILSA. That is essentially the rationale. So even without us imposing such measures, there are companies that have this on their mind, and I think we should test that proposition.

The third and final recommendation I would make is to harness divestment. There has been a considerable amount of very productive work done on the state and local level with regard to divestment of pension funds, publicly held pension funds, state pension funds, from Iran.

But it is hard to escape the notion that this work is done because of what Nobel Prize winning economist Jim Buchanan calls "government failure." Essentially, a failure to implement a robust economic strategy at the Federal level, has empowered these state and local initiatives. And this is exactly the reverse of how it should be.

Divestment is hugely important but only as an adjunct to strong Federal policy. Federal policy has to be driving economic pressure on Iran and divestment can be a tool in that toolbox.

Let me conclude just by saying that we need to understand that the clock is ticking. According to the latest projections from the International Atomic Energy Agency, Iran will have nearly 3,000 uranium enrichment centrifuges spinning in 16 separate cascades by late October. Based on those projections according to nuclear scientists and barring any unforeseen eventualities, glitches, technical breakdowns, Iran will have enough fissile material to field one nuclear weapon by this time next year.

So pretty soon, sooner than we think, the United States and its allies will be faced with the choices that my colleague talked about: To allow Iran to cross the nuclear threshold or to use force to prevent it from doing so. If we hope to avoid such a choice, we need to harness a serious economic strategy that leverages these latent vulnerabilities in a way to convince Tehran that the tangible costs of doing business, pursuing this nuclear technology, sponsoring terrorism, are far greater than the perceived benefits that such atomic acquisition, such international intransigence, would have. Thank you.

[The prepared statement of Mr. Ilan Berman follows:]

PREPARED STATEMENT OF MR. ILAN BERMAN, VICE PRESIDENT FOR POLICY,  
AMERICAN FOREIGN POLICY COUNCIL

Chairman Ackerman, Congressman Pence, distinguished members of the Subcommittee:

It is an honor and a privilege to appear before you today to discuss the issue of sanctions against Iran, as well as their potential implications for regional security. In recent months, the question of what to do about Iran's expanding nuclear ambitions, and when to do it, has taken center stage on the agenda of policymakers in Washington.

This discussion is all the more urgent because of Iran's apparent proximity to "the bomb." In February of this year, Director of National Intelligence Mike McConnell told the Senate Armed Services Committee that the U.S. intelligence community estimated that Iran could field a nuclear weapon by "early to mid next decade."<sup>1</sup> Today, however, new evidence suggests that the Islamic Republic may be much closer to an atomic capability than originally thought. Officials in Paris have told reporters that they believe Iran will have nearly 3,000 uranium enrichment centrifuges running by the end of this month. They base their assessments on a new analysis by the UN's atomic watchdog, the International Atomic Energy Agency, which states that the Iranian regime is expected to have 18 separate centrifuge cascades—totaling nearly 3,000 centrifuges in all—operational by late October.<sup>2</sup>

The finding is significant, and ominous. Nuclear experts say that 3,000 centrifuges represents a key atomic threshold. With that number of centrifuges spinning continuously for one year, a nation can generate enough highly-enriched uranium for one nuclear weapon. Based on these projections, and barring any technical glitches or other unforeseen eventualities, Iran will have enough fissile material to field a nuclear weapon by sometime next fall at the latest.

Currently, American strategy is not calibrated to respond to this development. Rather, for the past several years, the Bush administration's approach has centered on a slow-moving diplomatic effort to coerce Iran to abandon its nuclear ambitions via the United Nations.

To date, this track has tallied only modest results. In December 2006, the United Nations Security Council passed Resolution 1737, imposing sanctions on a number of known WMD suppliers to the Iranian regime, and setting the stage for additional financial measures if the Iranian regime continued its nuclear defiance.<sup>3</sup> Four months later, in March of this year, the Security Council passed Resolution 1747, which widened the scope of previous sanctions and imposed an embargo on weapons-related trade going into and out of the Islamic Republic.<sup>4</sup>

More robust action, however, has proven elusive. Despite continued Iranian intransigence and months of deliberations, the P5+1 (the United States, Great Brit-

ain, Russia, China, France and Germany) have been unable to reach consensus on supplemental sanctions against the Iranian regime. As a result of this deadlock, passage of a new, tougher sanctions resolution against Iran by the Security Council has been pushed off until at least November.<sup>5</sup> And even that deadline could slip considerably, should major disagreements remain.

This state of affairs is hardly surprising. After all, two members of the Security Council—Russia and China—are major strategic partners of the Islamic Republic. Over the past two decades, both countries have provided significant assistance to the Iranian nuclear effort. And while each has demonstrated a degree of cooperativeness with regard to sanctions against Iran, neither has been eager to impose truly comprehensive measures to curtail the Iranian nuclear effort. This reality means that the United Nations process will at best yield only incremental progress—and then only on those punitive measures that are deemed acceptable by Moscow and Beijing.

Even if Chinese and Russian cooperation is secured, another problem remains. It is already evident that Security Council action has failed to keep pace with Iran's nuclear progress. Fully a third of a year elapsed between the two existing Security Council resolutions, and the seven months since have passed without further UN action. Iran has used this time wisely, working diligently to add permanence to its nuclear effort. Given the compressed timeline for Iranian nuclear acquisition now confronting the international community, as well as the difficulty of attaining Security Council consensus, it is highly unlikely that the United Nations will be able to produce a resolution that significantly impacts Iranian capabilities, or alters regime intentions, in enough time to prevent Iran from crossing the nuclear threshold.

But if the United Nations track is indeed moribund, what options are available to the United States? Conventional wisdom has it that the United States possesses little leverage that it can bring to bear in order to deter and contain Iran's nuclear ambitions. In point of fact, however, the United States has a considerable number of economic tools at its disposal, despite its lack of trade relations with the Islamic Republic. America's allies and trading partners, who almost without exception maintain extensive economic ties to the Islamic Republic, possess even more. What has been missing so far has been a coordinated strategy that exploits the latent vulnerabilities in the Iranian economy. These include:

#### GASOLINE DEPENDENCY

Despite its massive oil production (some 3.8 million barrels daily), Iran is a voracious consumer of foreign refined petroleum, importing approximately 40 percent of its total annual gasoline consumption from abroad. During the last Iranian calendar year (March 2006 to March 2007), it spent some \$4.2 billion on gasoline purchases from sixteen countries: the United Arab Emirates (UAE), India, the Netherlands, France, Singapore, Turkmenistan, Azerbaijan, Sudan, Belarus, Turkey, Kuwait, Taiwan, Spain, Sweden, Saudi Arabia, and Bulgaria.<sup>6</sup> These deliveries were not surplus; the Iranian regime currently lacks a substantial domestic strategic petroleum reserve, maintaining just 45 days worth of gasoline inside the country.<sup>7</sup> And without one, even a partial cutoff of supplies would leave Tehran with just two options, both potentially threatening to regime stability: to raise prices, or to limit consumption.

Notably, the Iranian regime is acutely aware of this vulnerability, and actively attempting to eliminate it. In June, the Islamic Republic instituted a rationing plan establishing strict monthly quotas on gasoline for ordinary Iranians.<sup>8</sup> It likewise has attempted to institute steep cuts to its petrol purchases from abroad.<sup>9</sup> And regime officials have launched a major effort to ramp up domestic refining capacity, commissioning upgrades to existing refining facilities and the construction of new plants (although these added capabilities are not expected to come online until the end of the decade at the earliest).<sup>10</sup> All of which suggests that while the United States still has time to implement a petroleum embargo against the Iranian regime, its window of opportunity to do so is closing rapidly.

#### ECONOMIC HIERARCHY

Today, the vast majority of wealth in the Islamic Republic is concentrated in the hands of a small group of people, whose associates and relatives dominate the Iranian economy. The most public of these is the extended family of former Iranian president (and current Assembly of Experts chief) Ali Akbar Hashemi Rafsanjani, which now virtually controls copper mining in Iran, the regime's lucrative pistachio trade, and a number of profitable industrial and export-import businesses.<sup>11</sup> A related economic power center is Iran's *bonyads*, the sprawling, largely-unregulated religious/social foundations overseen by Iran's Supreme Leader. The sums controlled by these organs are enormous—estimated at more than 30 percent of Iran's national

GDP (and as much as two-thirds of the country's non-oil GDP).<sup>12</sup> Likewise, Iran's powerful clerical army, the Islamic Revolution Guard Corps or *Pasdaran*, is a major—and growing—economic force within the Islamic Republic, in command of numerous construction, industrial, transportation and energy projects and enterprises valued in the billions of dollars.<sup>13</sup>

Given this centralized economic hierarchy, targeted financial measures that restrict the ability of those “super-empowered” individuals and organizations to access international markets—and curtail their capacity to engage in commerce—are likely to have an immediate and pronounced effect on regime decisionmaking. Such measures include travel bans, asset freezes and account seizures. Many are already being considered by the United Nations as part of potential “smart sanctions” against the Iranian regime. But if consensus on their implementation cannot be reached at the UN—and even if it is—such steps are valuable tools that could be implemented by the United States and its allies in their efforts to pressure the Islamic Republic.

#### FOREIGN DIRECT INVESTMENT

Since the start of the War on Terror, Iran's economic fortunes have experienced a dramatic reversal. During the late 1990s, plummeting world oil prices had left the Iranian regime virtually bankrupt. Today, however, the energy-rich nation has reaped an unprecedented economic windfall as a result of global political instability. As of March 2006 (the end of Iranian calendar year 1384), officials in Tehran were publicly estimating their country's hard currency reserves at some \$50 billion.<sup>14</sup> Yet all of this has done little to diminish Iran's need for foreign direct investment. According to authoritative estimates, Iran's energy sector still requires some \$1 billion annually to maintain current production levels, and \$1.5 billion a year to increase this capacity.<sup>15</sup> Without such sustained capital, it is believed that Iran could revert from an energy powerhouse to a net energy importer in the span of very few years.<sup>16</sup>

Will it be possible to completely cut the Iranian regime off from international commerce? The answer is no. However, by using measures that target foreign investment and technology transfers into Iran, it is possible to slow the Islamic Republic's nuclear progress, complicate its access to foreign funding and/or force a further depletion of the hard currency reserves amassed over the past several years. Already, the Treasury Department's efforts—which include the blacklisting of two Iranian state banks from the U.S. financial system and the announcement of plans to designate the *Pasdaran* as a “specially designated global terrorist”—have had considerable effect. In recent months, a number of foreign companies and banks have given notice that they plan to scale back, if not sever outright, their financial dealings with the Iranian regime.<sup>17</sup> An important adjunct is the effort now visible at the state and local level to compel companies and financial institutions to scale back their level of investment in the Islamic Republic. “Divestment” has made significant strides since its start some two years ago; three U.S. states—Missouri, Florida and California—have already passed laws prohibiting their pension funds and state-owned enterprises from investing in Iran, and a number of others (including Pennsylvania, New York, Michigan, Massachusetts, and Georgia) have similar legislation pending or in the works.<sup>18</sup> With dozens of billions of dollars in U.S. funds still invested in companies that trade with Iran, this effort can have great utility in reducing the Islamic Republic's economic influence, if it becomes harnessed by the Executive Branch as part of a comprehensive effort to economically isolate the Iranian regime.

#### TRADE RELATIONSHIPS

Today, Iran boasts a combined total foreign trade of nearly \$100 billion annually.<sup>19</sup> The regime's largest trading partners are the European Union, Japan and the United Arab Emirates, which cumulatively account for over half of Iran's total global imports and exports each year.<sup>20</sup> (Germany alone boasts more than Euro 4 billion (\$5.45 billion) in trade with the Islamic Republic.<sup>21</sup>) The Iranian regime, moreover, is actively working to expand these economic relations, and to establish new ones (particularly with the countries of the “post-Soviet space”). It has been able to do so without major impediments because successive U.S. governments—irrespective of political affiliation—have consistently prioritized bilateral trade over international security. As a result, they have repeatedly failed to respond to violations of laws such as the Iran Libya Sanctions Act, which are aimed at curtailing Iran's support for international terrorism and ability to acquire weapons of mass destruction. In turn, waiver after waiver has convinced foreign countries and businesses that trading with Iran is effectively a cost-free venture.

This is deeply counter-intuitive, since the vast majority of Iran's trading partners boast far more extensive economic ties with the United States. In 2004–2005, for



example, Japan's annual two-way trade with Iran totaled some \$3.7 billion a year, while its commerce with the United States was *sixty times* that: \$180 billion annually.<sup>22</sup> If forced to choose, therefore, Iran's trading partners will inevitably prioritize their commercial relationship with the United States over keeping the current regime in Tehran in business. The goal of American policy should be to compel such a choice through aggressive application of existing legislation and new measures (such as the Iran Sanctions Enhancement Act) that convince foreign nations that they can trade with the United States, or with Iran, but not with both.

Today, despite years of diplomacy and international pressure, Iran's nuclear effort remains resilient—and has become increasingly mature. As a result, the United States and its allies are rapidly approaching a critical choice: whether to allow the Islamic Republic to cross the nuclear threshold, or to use force to prevent it from doing so. If they hope to avoid such a fateful decision, policymakers in Washington will need to implement a serious economic warfare strategy that leverages Iran's latent vulnerabilities to convince the regime in Tehran that the tangible costs of moving forward with its nuclear program far outweigh the perceived benefits of atomic acquisition. The time to do so, however, is running out.

#### NOTES:

<sup>1</sup> Director of National Intelligence John M. McConnell, "Annual Threat Assessment," statement before the Senate Armed Services Committee, February 27, 2007, [http://www.odni.gov/testimonies/20070227\\_transcript.pdf](http://www.odni.gov/testimonies/20070227_transcript.pdf).

<sup>2</sup> "French Officials: Iran Set to Run Nearly 3,000 Uranium-Enriching Centrifuges by Late October," Associated Press, October 3, 2007, <http://www.iht.com/articles/ap/2007/10/03/europe/EU-GEN-France-Iran-Nuclear.php>.

<sup>3</sup> United Nations Security Council, S/res/1737 (2006), December 27, 2006, <http://daccessdds.un.org/doc/UNDOC/GEN/N06/681/42/PDF/N0668142.pdf>.

<sup>4</sup> United Nations Security Council, S/res/1747 (2007), March 24, 2007, <http://daccessdds.un.org/doc/UNDOC/GEN/N07/281/40/PDF/N0728140.pdf>.

<sup>5</sup> Edith M. Lederer and Matthew Lee, "Key Nations Agree to Delay Iran Action," Associated Press, September 30, 2007, <http://ap.google.com/article/ALeqM5hIYBt5PA9hCg85Ze1WxFAQB8btuNgD8RUJ6581>.

<sup>6</sup> "Iran Imported Gasoline From 16 States in 2006," Mehr (Tehran), May 20, 2007.

<sup>7</sup> Study by Iran's Institute for International Energy Studies, as cited in Ali Nourizadeh, "Exploring Iran's Military Options," *Al-Sharq al-Awsat* (London), January 23, 2006, <http://aawsat.com/english/news.asp?section=3&id=3528>.

<sup>8</sup> See, for example, "Iran Bans Negative Petrol Stories," BBC (London), June 28, 2007, [http://news.bbc.co.uk/1/hi/world/middle\\_east/6249222.stm](http://news.bbc.co.uk/1/hi/world/middle_east/6249222.stm).

<sup>9</sup> "Iran Cuts Petrol Imports to Save Nearly \$3 Bln," Fars (Tehran), September 26, 2007, <http://english.farsnews.ir/newstext.php?nn=8607040520>.

<sup>10</sup> "Iran Faces a Gasoline Time Bomb," *Petroleum Intelligence Weekly* 45, iss. 38 (2006), 4.

<sup>11</sup> Paul Klebnikov, "Millionaire Mullahs," *Forbes*, July 21, 2003, [http://www.forbes.com/forbes/2003/0721/056\\_print.html](http://www.forbes.com/forbes/2003/0721/056_print.html).

<sup>12</sup> Ibid.; See also Kenneth Katzman, Statement before the Joint Economic Committee of the United States Congress, July 25, 2006, [http://www.house.gov/jec/hearings/testimony/109/07-25-06\\_iran\\_katzman.pdf](http://www.house.gov/jec/hearings/testimony/109/07-25-06_iran_katzman.pdf).

<sup>13</sup> Mehdi Khalaji, "Iran's Revolutionary Guard Corps, Inc.," Washington Institute for Near East Policy *Policywatch* no. 1273, August 17, 2007, <http://www.washingtoninstitute.org/templateC05.php?CID=2649/>.

<sup>14</sup> *Aftab-e Yazd* (Tehran), May 10, 2006, as translated in *Mideastwire Daily Briefing*, May 12, 2006, <http://www.mideastwire.com>.

<sup>15</sup> "NIOC Undertaking Host of Projects to Boost Oil Output," *Middle East Economic Survey* XLVIII, no. 19 (2005), as cited in A.F. Alhajji, "Will Iran's Nuclear Standoff Cause a World Energy Crisis? (Part 1 of 2)," *Middle East Economic Survey* XLIX, no. 13 (2006) <http://www.mees.com/postedarticles/oped/v49n13-5OD01.htm>.

<sup>16</sup> Kenneth Katzman, *The Iran-Libya Sanctions Act (ILSA)* (Washington: Congressional Research Service, July 21, 2003), 2; See also "Iran: U.S. expert predicts oil-export crisis within a decade," *Radio Free Europe*, January 12, 2007, <http://www.rferl.org/featuresarticle/2007/01/DC93E2C3-0923-4575-84E9-808C49EEB513.html>.

<sup>17</sup> "Iran: Top U.S. Official Says Financial Clampdown Is Working," *Radio Free Europe/Radio Liberty*, October 17, 2007, <http://www.rferl.org/featuresarticle/2007/10/80f509a4-06d7-4416-9a28-0410a0e9113b.html>.

<sup>18</sup> Michael Barone, "Divest Iran," *RealClearPolitics*, August 27, 2007, [http://www.realclearpolitics.com/articles/2007/08/divest\\_iran.html](http://www.realclearpolitics.com/articles/2007/08/divest_iran.html).

<sup>19</sup> Extrapolated from "Country Profile: Iran, Islamic Rep. of," World Trade Organization, April 2007, [http://stat.wto.org/CountryProfiles/IR\\_e.htm](http://stat.wto.org/CountryProfiles/IR_e.htm).

<sup>20</sup> Ibid.

<sup>21</sup> Ralf Beste, Christoph Pauly and Christian Reiermann, "US Pressures Germany to Cut Iran Business Ties," *Der Spiegel* (Hamburg), July 30, 2007, <http://www.spiegel.de/international/business/0,1518,497319,00.html>.

<sup>22</sup> "Islamic Republic of Iran-Statistical Appendix," International Monetary Fund *Country Report* no. 04/307, September 2004, <http://www.imf.org/external/pubs/ft/scr/2004/cr04307.pdf>; Wendy Cutler, Testimony before the Ways and Means Committee of the U.S. House of Representatives, September 28, 2005, <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=3793>.

Mr. ACKERMAN. Thank you very much. Dr. Gordon, you suggested that the EU3 initiative in 2003 was a consequence of European fears that, as you say, without a new diplomatic effort, then the United States might use military force against Iran. First, do you know if the Bush administration was at all explicit in this regard, or were the EU3 responding to the bellicose rhetoric, such as "axis of evil" and all that? And at the early stage, do we know anything of the nature of the coordination between the EU3 and the U.S.?

Mr. GORDON. Shall I answer that now, Mr. Chairman?

Mr. ACKERMAN. Yes.

Mr. GORDON. I think the latter. I don't believe it was a case of explicit coordination or even threats. It was simply emerging from the context of the time. The United States built a case for, then invaded Iraq; in the spring and summer of 2003, was feeling very confident and powerful, and there was all sorts of talk about who is next. You will remember that debate. And the Europeans were following that closely.

And in the context of that, information starts to emerge that shows that Iran had a much more developed nuclear program than most of us and certainly the Europeans believed that they had at the time, and so the Europeans said to themselves, I think appropriately, what can we do to avert this war between the United States and Iran over its nuclear program? That was of course before the insurgency in Iraq made America feel rather than all-powerful vulnerable, and so they decided to get active on the diplomatic front.

And they went to Iran, again at a time where the United States was powerful and Iran was weak, as I believe Mr. Sherman or somebody suggested earlier, and said, you know, look, here is the deal: Suspend your uranium enrichment and we can talk about negotiating this. And at that time, Iran was indeed prepared to negotiate.

So that is the link I see between American threats of force and European seriousness on the diplomatic side. The one thing I would add to it, in other words, it is helpful to a degree for there to be a prospect of United States military conflict with Iran because it makes other countries realize how serious this issue is. The one thing I would, though, is that we need to calibrate it very carefully, because up to a point, I believe it is helpful in rallying the world to get more serious about Iran. There is a tipping point, however, somewhere in there where the United States looks excessively bellicose, unwilling to engage with Iran, which leads the others, instead of getting engaged diplomatically on our side, to back off and say, whoa, wait a minute, we have to be careful with the United States.

Mr. ACKERMAN. Could you tell me who is paying for Iran's nuclear development, nuclear weapons development?

Mr. GORDON. Who is paying for it?

Mr. ACKERMAN. Yes.

Mr. GORDON. Well, in some ways, we are every time we fill up the pump. High oil prices have made—despite all of the problems within the Iranian economy that we have talked about—

Mr. ACKERMAN. That is in general, but we are not buying oil directly from them.

Mr. GORDON. No, but of course, oil being fungible, everyone who is buying oil is helping to drive up the price, and whoever they sell it to—and actually you raise a very important issue which we haven't talked about and it is interesting the degree to which we don't talk about the obvious, which is if one really wanted to increase the costs on Iran, we, we meaning everyone, would stop buying its oil. Now that would be a serious measure from the U.N. Security Council to make it illegal to purchase Iranian oil. I think that would be——

Mr. ACKERMAN. Illegal for who?

Mr. GORDON. I am sorry?

Mr. ACKERMAN. Illegal for who? The world?

Mr. GORDON. For anybody. If the Security Council decided—and the Security Council already passed a resolution making it illegal for Iran to enrich uranium. The Security Council demanded Iran suspend enrichment. Iran is in violation of that Chapter VII Security Council resolution.

The Security Council, we are in a theoretical world here because there is such strong opposition to it, but if the Security Council came together and said because Iran is in violation of that resolution, we hereby declare it illegal for any country in the world to purchase Iranian oil exports, the Security Council could do that and that would be very serious. And then the Iranians would really know that they are paying a price.

Mr. ACKERMAN. And who would not participate?

Mr. GORDON. Who would not participate? I mean, there would be leakage as there was in Iraq.

Mr. ACKERMAN. Could anybody, for example, with the power to do so veto such a resolution?

Mr. GORDON. That is right, and that is why we are not talking about it.

Mr. ACKERMAN. Okay. So let us look at stuff that maybe we could do. Let me rephrase my question. Is there foreign capital investment in Iran's nuclear weapons program? Do we know? Do we think there is?

Mr. GORDON. I think the Iranian Government has access to plenty of cash flow that that is not the major constraint. It is not a question of direct——

Mr. ACKERMAN. Mr. Berman, do you agree? Do you suspect that is so?

Mr. BERMAN. I do. Being a lawyer, I have to do the usual caveat this is only, you know, heard sixth hand and therefore subject to revision upon——

Mr. ACKERMAN. Footnotes 2 to 9, okay.

Mr. BERMAN. But as I hear it, the Germany company, Siemens, was at one point several years ago heavily invested in the Iranian nuclear program.

Mr. ACKERMAN. Nuclear energy program?

Mr. BERMAN. Nuclear energy program. And I have no guidance——

Mr. ACKERMAN. Nuclear weapons program.

Mr. BERMAN. Well, the problem here if, I may, is that the structure under which Iran is developing its nuclear program is a flawed one. It allows Iran to go 90 percent of the way toward ac-

quiring a bomb without actually declaring. Therefore, the same centrifuge that can spin uranium to low enrichment can spin it to high enrichment if you reprocess the uranium and send it through the centrifuges again. Therefore, it is very hard to create a distinction between who is assisting the nuclear energy program and who is assisting the nuclear weapons program.

Mr. ACKERMAN. So Siemens' participation does not continue on today?

Mr. BERMAN. I do not have current knowledge, sir.

Mr. ACKERMAN. Is it more expensive to build a nuclear weapons facility than say an oil refinery facility?

Mr. BERMAN. I would say that you hit upon a key point, because if Iran was serious in doing what it says it is doing when it is building a nuclear program, which is to create an alternative source of energy, if it was really serious in alleviating the energy prejudice on its population, it would quite clearly build more refineries. It is much cheaper to build a refinery.

Mr. ACKERMAN. That is the question I am trying to get a foundation for. Are they just not smart enough to figure out that they should have a refinery?

Mr. GORDON. I will just add one thing. One of the things that emerged from the extensive European discussions with the Iranians was that the Europeans kept saying we suspect that your enrichment program is not an energy program but a military program because you don't have the nuclear power plants to require the enriched uranium that you are in the process of building, and according to our statistics, you would need 24 of these reactors in order to—make that power plants—in order to make that economically viable.

Well, guess what? The Iranian Government has decided to build that many power plants. So it is now more defensible that they are trying to enrich that much uranium so they can have power plants to use them.

Mr. ACKERMAN. But if we are playing chess with them and the squeeze as we have sort of been inching over to is going to be to cut them off from revenue from oil, which basically renders them impotent to a large measure, why wouldn't they plan one move ahead and refine their own oil?

Mr. BERMAN. Quite simply because—

Mr. ACKERMAN. Why don't they do that first in the money they save by producing their own oil instead of importing oil where they can get hurt?

Mr. BERMAN. If I may, Chairman Ackerman, because currently they do not have the ability to do so, not enough to sustain domestic needs. The amount that they are spending on foreign refined petroleum suggests that in addition to having skewed priorities in their energy sector, where they send 60 percent of it abroad as a strategic commodity, even if they kept that oil in country to use for the betterment of their people, they simply do not have the resources at least currently to refine it in order to make it usable for ordinary Iranians.

Mr. GORDON. And that reinforces the point about how important it is for us to prevent investment in it.

Mr. ACKERMAN. I am missing something. I mean, I get all that. They don't do it because they don't do it. But if they did it, they would do it. [Laughter.]

I mean, if they have enough money to build nuclear bombs, which I think cost a lot of money, why don't they just—and they are not necessarily smart enough to invent the nuclear bomb. I mean, they are buying the technology. They are buying the resources. They are buying whatever they have to buy. They are buying the talent. There are a lot more people who know how to make gasoline than who build nuclear weapons plants.

Mr. BERMAN. No, I agree, and I think you hit upon the exact point, which is that—

Mr. ACKERMAN. I hope they are not listening.

Mr. BERMAN. It speaks to their intentions. This program at least in my opinion has very little to do with the acquisition of a sustainable alternative energy source for them. It has everything to do with acquiring strategic capabilities.

Mr. GORDON. Yes. I would just add that developing refining, petroleum refining capability in industry is not cheap or easy, and that is precisely why they need foreign investment in technology. As we know in this country, expanding your refining capability is a costly and difficult thing. So you can say, "Why aren't they doing it?" One reason they are not doing it is it is a massive undertaking, but they are getting started with that process precisely to reduce their vulnerability to the types of measures that Mr. Berman talked about.

Mr. ACKERMAN. Mr. Pence?

Mr. PENCE. Thank you, Chairman. Thank you to both of the witnesses. I want to pursue a line of questioning on the issue of divestment. I was in Florida not long ago. I think Florida if memory serves became the first state legislature to effectively divest their state pension from corporations that invest actively in Iran.

On page 5 of your testimony, Dr. Gordon, you make a very emphatic statement if I can characterize it that way that the United States should do more to put public pressure on the companies that are making significant investments in Iran. You refer to including private sector firms and public and private pension funds.

When I was in Ankara, Turkey, about a year ago, Mr. Rafsanjani I think was his name had just been through town. I was lunching with some members of Parliament in Turkey. And I asked them about this, the looming specter of a nuclear weapons program in Iran, and after being very quiet for most of the lunch, the head of the majority party finally spoke up, looked me in the eye with a wry smile and he said, Iranians are very good negotiators. And I looked at him and said, are we in a negotiation, or is this a looming crisis?

And so I guess in the context of divestment, and you, Mr. Berman, said we need to harness divestment, does this raise the cost? Is this the kind of leverage in a real negotiation that can get them to walk back from the nuclear brink? I guess I am trying to get at, and I caught this a bit in the chairman's questioning, where is the real pressure point here? And each of you had several recommendations, but one of the common ones was this issue of divestment. Is that a pressure point? What specifically could this committee or

this Congress do if it is an effective pressure point to drive further divestment?

Mr. GORDON. Here is what I think about that. I made clear in my written testimony and in my remarks here that I worry about the effect of secondary sanctions that I fear get us into tit-for-tat retaliation with the European Union and other countries. There is a difference, though, between that and the types of divestment measures that I recommended, that Mr. Berman recommended, that I think can be very effective.

We talked about even the naming and shaming issue and the moral pressure. Imagine if every Member of Congress, if we had this list of published firms around the world that are investing significantly in the Iranian energy industry or in Iran period and every Member of Congress took that list back to their constituencies and met with fund managers and state pension fund holders and citizens and said these are the companies that are propping up the Iranian economy, we are not going to pass a law that leads us into trade disputes with some of our major partners. We can debate that part of the issue. But we think you should know that business with these companies is propping up the Iranian economy, allowing them to alleviate the vulnerabilities we have been talking about, to invest in centrifuges and all the rest.

I think that kind of moral persuasion and naming and shaming would have a real effect, and it would play its way out through the global economy and have an impact, a further impact, in Iran, because I think the bottom line on this is this Iranian Government may well not be subject to any kind of pressure, but the Iranian people can have a say in this, and that is the greatest leverage I think we have.

Mr. PENCE. Yes. I mean, that is the real question. I want to get Mr. Berman's response before I yield back, but is it effective pressure?

I am all for that. I am all for every state legislature, including Indiana, passing the kind of restrictions that Florida passed. But capital being fungible in a world economy, do we cut off our nose to spite our face, or is there in your judgment real impact on ground?

Mr. GORDON. I will say one thing, and then Ilan can take over. Look, we don't know. The United States has sanctioned Iran for 28 years and it hasn't worked. That is why a lot of people say this is a waste of time and it can't work.

But as again I made clear in my remarks, there are other cases where, especially when it is multilateral and the world gets together and imposes sanctions over the long-term as they did on South Africa, it wasn't easy for the South African Government to take decisions that effectively led to its downfall. Libya gave up its weapons of mass destruction program and got out of the business of terrorism. Serbia conceded on a range of issues. It can be effective.

And Iran is actually a relatively good candidate compared say to Iraq, where we had 12 years of sanctions, but you had a dictator who had no intention of giving up. Iran has a civil society and has people prepared to challenge the government, and we have seen

that in Iranian politics. So no one can guarantee that that would work, but it is certainly plausible that it would have an effect.

Mr. PENCE. Mr. Berman, do you think that pressing global corporations that are doing business in Iran or pushing them farther out of United States capital markets would have an echoing effect into the Iranian economy that would create pressure?

Mr. BERMAN. Oh, absolutely. I think the amount of as you called it yeoman's work that has been done in terms of limiting state exposure on the issue of Iran, and in some cases looking a little broader at the idea of terror-free investing generally, is fantastic.

The problem that we run into, and this is why I talked about weaponizing, about harnessing it, is essentially one of timing. If the timeline that I laid out is correct, even if it is double that or triple that, we have a problem. We are looking at a timeline for divestment where we have been working at divestment for over a year, really working at divestment, and only have about a dozen states in various states of play. So the real question becomes, How can the Federal Government empower this and accelerate this process? How do you add an accelerant?

I think the key here is reputational risk. If you have not only the Treasury Secretary, although that would be helpful, but also, for example, the SEC chairman begin talking about companies, specifically naming and shaming companies, this is a company that is doing business with Iran, with the world's leading state sponsor of terrorism, and Americans shouldn't invest in it, it would have a dramatically amplifying effect on a lot of the things that state legislators are trying to do quietly in their respective districts.

Mr. PENCE. Yes. I thank you for the testimony. Mr. Chairman.

Mr. ACKERMAN. Before we go to Mr. Berman, if I might impose some feedback on that, on the question?

Mr. PENCE. I am pleased to yield.

Mr. ACKERMAN. What the state legislatures are doing, should we by dent of Federal law try to effectuate the nonparticipation of United States pension funds, 401[k]s, et cetera, that are investing in foreign companies that are investing in the Iranian oil sector, should we try to disincentify that by law?

Mr. GORDON. I worry, as I suggested before, that when these things are done by law, they risk creating countervailing pressures among others, and I am obviously referring to the European Union. I don't know how they would react to a law as opposed to a public naming and shaming exercise. The reality is other countries—

Mr. ACKERMAN. There are some countries that have no shame.

Mr. GORDON. There are indeed countries that have no shame. But no countries like to be bullied by other peoples' legislatures.

Mr. ACKERMAN. Right.

Mr. GORDON. And what I would worry about there is if they felt that they as a matter of principle, not that they disagreed with the specific issue but as a matter of principle they didn't want the United States Congress dictating their economic future any more than, for example, we would want a European Parliament to ban their firms from investing in companies that don't limit their carbon emissions in the United States. So that is my concern is that it could be counterproductive, but I don't know specifically.

Mr. ACKERMAN. What if we didn't affect air policy directly but affected our own policy by disincentifying the tax advantages that would be gained on the profit end even to the person who was the person paying into the pension fund so that I tell my pension fund and you tell yours we don't want them investing in such and such company that is investing in the Iranian economy or oil sector? Cut the tax advantage in half, the tax part of it.

Mr. BERMAN. If I may, I think that is a key part of it, but I think it is important to remember that the reason I am such a strong champion of Federal ownership of the divestment portfolio is because the executive can provide both sticks and carrots on divestment. It can talk about not only mandating for states to disincentivize investment in Iran but also to talk with those companies, to sidebar with those companies and explain to them that they will be receiving economic advantages that would compel them to be more constructive, because we are not the only market that they have.

So it is useful not only for us to be insulated from supporting the Iranian regime but also generally speaking for these companies to cease business in Iran, and that is something the executive, not only the states, have the ability to do.

Mr. ACKERMAN. Let us move on to Mr. Berman, see if we can move expeditiously before the next series of votes. Maybe we could have a shot at wrapping it up or not.

Mr. BERMAN OF CALIFORNIA. The Europeans were reacting according to you, Dr. Gordon, to a concern that the United States coming off of a high in Iraq might do something with respect to Iran. They clearly don't want a military confrontation with Iran. Do the Europeans clearly not want Iran to have a nuclear weapon? Do they consider that an unacceptable alternative? It is pretty clear the French Foreign Minister and maybe the new President of France feel that way, but has Europe internalized the notion that the nonproliferation regime goes, who knows what could happen if Iran gets a nuclear weapon, proliferation in the rest of the Middle East moves ahead? Have they internalized the unacceptable nature of the consequences of Iran getting a nuclear weapon?

Mr. GORDON. I think the short answer is yes.

Mr. BERMAN OF CALIFORNIA. If they think those are the two unacceptable alternatives, the military conflict and Iran getting a nuclear weapon, I guess that is why you think a toughened sanctions regime has some hope.

Mr. GORDON. Yes. And why I think the Europeans have shown movement on it in the past couple of years as they start to realize that the choice becomes either acquiescing to an Iranian nuclear weapon, which they realize, they think it through, they know it would mean the end of the nonproliferation regime and spillover.

Mr. BERMAN OF CALIFORNIA. And explain to me why some bellicose statements and the proclivities of this administration help create a European desire to negotiate an end to the Iranian enrichment cycle or a suspension of it, but unilateral actions by the Congress to tighten up on sanctions and move further produce the exact opposite result? Particularly in the context, today a newspaper, I don't know how reliable this report is, reports that Russia's second largest oil company, Lukoil, has suspended its invest-



ment in a particular energy sector product, citing the existing law, ILSA, not the new law, which hasn't passed, and the jeopardy they will have in their merged operations with a U.S. company in terms of doing business in the United States?

Mr. GORDON. I don't think there's any doubt that the threat of unilateral American secondary sanctions has an effect and is on the minds of major European companies. There is no doubt about it. We did, however, see last time reaction, as I said, to the principle of one legislature deciding who can do what.

Mr. BERMAN OF CALIFORNIA. What did we see?

Mr. GORDON. We saw the European Union preparing retaliatory sanctions and preparing to pass laws that barred European companies from abiding by United States legislation, because the U.S. legislation would be in contradiction to their own and international legislation, and we saw preparation of lawsuits at the World Trade Organization.

Mr. BERMAN OF CALIFORNIA. But our sanctions are not directed at those countries. They are directed at those companies.

Mr. GORDON. That is right.

Mr. BERMAN OF CALIFORNIA. That is different. I mean, I don't quite understand the difference between name and shame and sanctions directed at companies.

Mr. GORDON. Well, name and shame is moral pressure. Again, I think and I share the goal of stopping those companies from doing any investment in Iran. The question is a purely practical one of what happens if we do it. And if the answer is it turns into a huge trans-Atlantic dispute about the principle of secondary sanctions rather than the trans-Atlantic consensus about isolating Iran, then it is not working for us.

And as I said, just the analogy, if the Europeans think that global warming is a terrible tragedy about to happen and American companies aren't doing enough to stop it, imagine if the European Parliament said that any European investing in a United States company that's not acting on global warming, we might have some resistance to that here too. So I do think it is about the principle.

Mr. BERMAN OF CALIFORNIA. Some Americans wouldn't mind that.

Mr. GORDON. Fair enough.

Mr. ACKERMAN. Thank you, Mr. Berman. If it is okay with our colleagues because of the impending votes, perhaps we can each do 2 minutes and avoid the necessity of keeping our two panelists waiting for our return and wrap it up now.

Mr. SCOTT. That would be fine. Thanks for your testimony. It looks like we are at a point, I mean, I am not very optimistic with your testimony. I really think we are on a collision course, and I really think that we are almost at one of these O.K. Corral moments.

And in that regard, in our failure to get these sanctions and get these other countries, foreign countries, to cooperate with us on sanctions, and given the fact that literally in months from your testimony, Mr. Berman, Iran will have a nuclear weapon, and if it is the will of the world that Iran not have a nuclear weapon, would you recommend that the United States begins to take a tact of gathering forces with other nations so that if the only resolve we

have, because if we say they can't get them, then military action must be on the table, would not it make sense to begin a movement to corral other nations so that if there is this military strike, it is not a unilateral military strike by the United States but that it is a worldwide effort as a last resort?

We have tried these sanctions. We just passed a sanctions bill doubling the sanctions and moving forward, but it just seems to me that the thing that gets attention is when the President of the United States or the Vice President says we will not tolerate Iran having a nuclear weapon. Don't you think it would be more powerful if that "I" gets changed to "we will not tolerate"?

Mr. GORDON. Thank you, Mr. Scott. I am not optimistic either. I would say on the specific point that you raise about rallying other countries to support a potential military strike, if the United States had to act militarily, it would be a wonderful thing to have support.

In my assessment, the number of countries that would support a United States military strike on Iran's nuclear program would be between zero and three. The other countries just don't believe that a military strike on the Iranian nuclear program would be a positive thing. We would have far less support for that even than we did on Iraq. Most countries around the world would feel that a military strike would lead to even more determined Iranian efforts to get a nuclear weapon, undermining of our efforts in Iraq and Afghanistan and greater terrorism. So I am afraid while what you say makes imminent sense that we would fail in that endeavor.

Mr. SCOTT. So you believe then that their objection to it is weak and that in effect, these other countries would in effect rather than a military strike would accept the reality of Iran having a nuclear weapon?

Mr. GORDON. Oh, I absolutely believe that, which is not necessarily to say, and this is what I would plead for, that it is total acquiescence, I mean, that is the heart of argument, even if we fail, because frankly, we may fail in the next, whether it is a year or 2 years or 3 years. Even if we rally international support for sanctions, we may fail to persuade them to stop enriching uranium, and they might even develop a nuclear weapon. But if that happens, there still needs to be a price for that, and there needs to be a containment regime of Iran.

So I wouldn't let ourselves boil it down to total acquiescence and let them become a full-fledged nuclear power on one hand or military action on another. I will just remind us that in the case of a number of other countries, we didn't want them to get a nuclear weapon either and we ended up having to fight the Soviet Union, China, Pakistan, North Korea. And these were not countries that we were delighted about seeing acquire nuclear weapons, and we ultimately had to settle for a second best alternative, which is some form of containment and economic price.

Mr. BERMAN. If I may, I think you have it exactly right, and I think the administration frankly needs to do much more to telegraph that there is a continuum here. Not that we talked at the U.N. and the hour is getting late and if we don't reach some sort of resolution, then fine, we don't resolution. But that there is a logical continuum, there is a spectrum of escalation, and that countries who are invested in preventing a conflict with Iran should

sign up to economic initiatives so that they don't face some sort of military action.

By way of anecdotal evidence, I returned recently from a fact-finding trip to China, and there was a remarkable degree of that disconnect present when I talked to officials in Beijing. There was the assumption that the U.N. track is self-contained and if no resolution proceeds, no third resolution proceeds from U.N. negotiations, then that is the end of the story and Iran goes nuclear and everything is fine. There is no discussion about the fact that we will have to implement follow-on measures, possibly unilaterally.

Mr. ACKERMAN. Ms. Jackson Lee?

Mr. SCOTT. Thank you.

Ms. JACKSON LEE. Well, let me thank the witnesses, and I will talk as quickly as I can in light of the present state of floor votes. Dr. Gordon, let me just speak the obvious, which is what you just said. Pakistan, North Korea, a whole list of individual nations are with nuclear. The uniqueness of Iran is what I believe is the strong if you will middle class and continuing to hear from Iranian-Americans who say no unilateral attack, no Iraq.

And my question then is, one, have we lost our way diplomatically by continuing to ignore the Iranian resistance group that continues to press to return to Iran? Second, is diplomacy relevant as relates to Iran's stage as to where they are with the 'nuclear research' I will call it? Can diplomacy work? And three, I don't want to say that we have no options, but I frankly believe that the option of a unilateral attack is ridiculous, and I think containment, strong containment with collaborative partners, sanctioning the funneling of their oil resources since they are 40 percent dependent on outside oil resources, that is the answer, and I welcome your response to that since I had to talk very quickly and could not lay out a wonderful exposé for you to let you know what my thoughts really are. Dr. Gordon.

Mr. GORDON. Thank you very much. I mean, there is a lot in there, as you say. Time is limited. I would say time is clearly not on our side when it comes to the nuclear enrichment program. They are moving quickly, and that clock is ticking faster than our efforts to make them pay a price for it is moving.

I am a little bit more optimistic in the long run. I think time is on our side in terms of the future of the Iranian Government. I think the Iranian people have lived with this regime for almost 30 years. They don't like it. There is a growing youth population in Iran that wants to see a different future.

We have very little control over these things, but I think that in the long run, we can't do this for them, but the Iranian people are going to decide that they want their country to have a different orientation. We can help it along, and we can just as we did with the Soviet Union over a number of decades increase the strains as we contain it until they choose a different and better future.

Ms. JACKSON LEE. So should we work to do something other than a unilateral military attack?

Mr. GORDON. Yes. I think a unilateral military attack would have great risks associated with it.

Ms. JACKSON LEE. So we need to be energized on the diplomacy, the recognition of this I think energized to use the term twice opposition in Iran.

Mr. GORDON. I think there is opposition in Iran. I think I would be very careful about us getting too directly involved in fomenting and funding especially violent opposition within Iran.

Ms. JACKSON LEE. I thank you. I don't know if Mr. Berman had a response, but I think I have heard your comments about sanctions. I just want to conclude, Mr. Chairman, by simply saying I want us engaged, engaged, engaged and to be able to use your expertise, but I believe that that has to be the way along with collaborative European allies and China to work with us.

Mr. ACKERMAN. We thank the panel for their excellent testimony, participation in answering the questions of the members of the subcommittee. The subcommittee stands adjourned.

Mr. GORDON. Thank you.

[Whereupon, at 4:28 p.m., the subcommittee was adjourned.]

## A P P E N D I X

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### MATERIAL SUBMITTED FOR THE HEARING RECORD

#### PREPARED STATEMENT OF THE HONORABLE RUSS CARNAHAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Chairman, thank you for hosting this hearing to discuss Iranian sanctions and regional security. Thus far, economic sanctions have resulted in little progress in Iran. The Iranian regime still defies the international community by continuing uranium enrichment and expressing its intention to pursue nuclear technologies. We must be clear on what is at stake here; a nuclear Iran would dramatically shift the balance of power in the Middle East, which would have dire consequences for the region.

For economic sanctions to succeed, we must proceed with caution and they must have a narrow focus. These sanctions must limit the financial freedoms of the Iranian leadership, while doing the least amount of damage to the Iranian people. In the past, when economic sanctions were imposed on Iraq and Libya, the people of these countries shouldered a majority of the burden, we must not allow this to happen in the case of Iran.

In order for economic sanctions to restrict the Iranian regime financially, they must be supported by the international community at large. The United States has imposed unilateral sanctions on Iran for over three decades, which have failed to significantly pressure the Iranian regime. However, if our allies support these economic sanctions, it may intensify the pressure enough to bring Iran to the bargaining table.

There are also steps we can take here at home to bring further pressure on the Iranian regime. In my home state of Missouri, we have enacted legislation to divest from companies that do business with Iran and other nations on the State Department's list of countries that sponsor terrorism. The implementation of these domestic and international strategies can work together to further pressure the Iranian regime.

I am eager to hear our witnesses' evaluations on Iranian sanctions and suggestions on making them more effective. Thank you for taking the time out of your busy schedules to appear before us today. I look forward to hearing your testimonies.

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#### PREPARED STATEMENT OF THE HONORABLE SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman, thank you for convening today's important hearing. The current state of affairs in Iran, and specifically those issues relating to U.S. sanctions on Iran and the security of the region, are extremely important and in desperate need of discussion. I would also like to thank the Subcommittee's Ranking Member, and to welcome our distinguished witnesses, Mr. Philip H. Gordon, Senior Fellow for U.S. Foreign Policy in the Foreign Policy Studies Program at the Brookings Institution; and Mr. Ilan Berman, Vice President for Policy at the American Foreign Policy Council. I look forward to your testimony.

We are here today to discuss the situation regarding Iran's nuclear program, to assess the reactionary role the U.S. has played thus far, and to decide how we should deal with this situation moving forward. As a Member of Congress, I find Iran's support of terrorist organizations, pursuit of nuclear weapons, and dismal human rights record to be extremely worrisome. However, I am also concerned by what appears to be movement by this Administration toward yet another war in the

Gulf region, without having first exhausted diplomatic means of addressing any conflicts.

I have long been an advocate of a free, independent, and democratic Iran. I believe in an Iran that holds free elections, follows the rule of law, and is home to a vibrant civil society; an Iran that is a responsible member of the region and the international community, particularly with respect to the proliferation of nuclear weapons. An Iran that, unfortunately, we do not see today.

The only effective way to achieve lasting peace and prosperity in the region, along with bringing about reforms in Iran's polity, is to assist the Iranian people in their quest to achieve political, social, and religious liberty. Every government can be judged with the way in which it treats its ethnic and religious minorities, and the current Iranian government gets a failing grade for its treatment of its many and diverse minorities.

Given the government's poor record for transparency and accountability, the International Atomic Energy Agency's (IAEA) inability, despite intensified inspections since 2002, to verify that Iran's nuclear program is not designed to develop a nuclear weapon is cause for great concern. While Iran states that the intention of its nuclear program is for electricity generation which it feels is vital to its energy security, U.S. officials challenge this justification by stating that "Iran's vast gas resources make a nuclear energy programs unnecessary."

The controversy surrounding Iran's procurement of nuclear energy is cause for great concern, however, the administration's avoidance of any and all diplomatic relations with Iran are cause for greater alarm. Moreover, the current rhetoric from the Bush Administration regarding war with Iran is both counter productive and highly inflammatory. While full diplomatic, political, and economic relations between the U.S. and Iran cannot be normalized unless and until enforceable safeguards are put in place to prevent the weaponization of Iran's nuclear program, these policy objectives should not constitute pre-conditions for any diplomatic dialogue.

Establishing a diplomatic dialogue with the Government of Iran and deepening relationships with the Iranian people would help foster greater understanding between the people of Iran and the people of the United States and would enhance the stability the security of the Persian Gulf region. Doing so would reduce of the threat of the proliferation or use of nuclear weapons in the region, while advancing other U.S. foreign policy objectives in the region. The significance of establishing and sustaining diplomatic relations with Iran cannot be over-emphasized. Avoidance and military intervention cannot be the means through which we resolve this looming crisis.

I look forward to our meaningful discussion and a new foreign policy strategy with regard to Iran. Thank you, Mr. Chairman, and I yield back the balance of my time.

